VZCZCXRO0453
RR RUEHAST RUEHBI RUEHCI RUEHLH RUEHNEH RUEHPW
DE RUEHNE #0022/01 0061252
ZNR UUUUU ZZH
R 061252Z JAN 09
FM AMEMBASSY NEW DELHI
TO RUEHC/SECSTATE WASHDC 4934
INFO RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE
RUCPDOC/DEPT OF COMMERCE WASHDC
RHEBAAA/DEPT OF ENERGY WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RULSDMK/DEPT OF TRANSPORTATION WASHDC
RUEHRC/DEPT OF AGRICULTURE WASHDC

UNCLAS SECTION 01 OF 02 NEW DELHI 000022

SIPDIS
SENSITIVE

STATE FOR SCA/INS AND EEB
USDOC FOR ITA/MAC/OSA/LDROKER/ASTERN/KRUDD
DEPT PASS TO USTR MDELANEY/CLILIENFELD/AADLER
DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA MNUGENT
TREASURY PASS TO FRB SAN FRANCISCO/TERESA CURRAN

E.O. 12958: N/A
TAGS: EAGR ECON EFIN EINV ETRD IN

SUBJECT: INDIA PRODS ECONOMY WITH MORE FISCAL AND MONETARY STIMULUS

REFTEL NEW DELHI 00003177

¶1. (SBU) Summary. On January 2, the government announced additional fiscal and monetary steps aimed at reviving economic growth, mainly through lowering the cost of borrowing to banks -- to pass on to consumers - as well as easing policies aimed at helping hard hit sectors of the economy, especially infrastructure. This second package, less than a month after the first, reflects the government's continued concern over signs of a slowing economy. As noted before in reftel, the government's ability to spend its way out of an economic slowdown is limited, but it appears to be making well-targeted efforts with what tools it has. The central bank's moves to lower the cash reserve ratio (CRR) as well as the two key policy benchmarks of the repo and reverse repo rate are meant to encourage more lending and add liquidity to the system. While in the right direction, they may still not be enough to encourage banks to lend to those whom they see as riskier borrowers. However, the liberalized foreign financing norms are welcome. End summary.

FISCAL STIMULUS PACKAGE

¶2. (SBU) Rumored for several weeks, the government announced a second stimulus package late on January 2, coordinated between the central bank and the Ministry of Finance. With little spending room, the government focused on easing or removing policy hurdles to states' and financial institutions' ability to borrow, as well as increasing exporters' refunds on imported inputs. The package provides authorization for state governments to raise additional borrowing of $6 billion. The stimulus also attempts to help revive the domestic sales of automobiles, which slumped in October and November, traditional festival (and spending) months. The main financial channel for personal automobile financing in India has been non-bank finance companies (NBFCs), which have suffered from the drying up of their conventional borrowing sources. The package provides them liquidity support as well as permitting them access to foreign borrowing from multilateral and bilateral official agencies for infrastructure.

¶3. (SBU) The biggest boon of the fiscal package was reserved for infrastructure, already a beneficiary of the earlier stimulus package and a sign of the continued importance that the government gives to maintaining progress in this capital-intensive sector. The package authorizes the government-owned India Infrastructure Finance Company Ltd. (IIFCL) to raise an additional Rs 300 billion (roughly $6 billion) in tax-free bonds once it has successfully utilized the earlier Rs 100 billion authorized under the December package.

¶4. (SBU) The other major boost to infrastructure is through liberalization of the government's External Commercial Borrowing (ECB) policy and significantly enhanced ceilings on foreign investment in corporate debt market. The January 2 package removes the government's caps on permitted interest rate ceilings (also called "all-in-cost" ceilings) as well as expanding the end-use norms to include integrated townships (planned residential communities). Notably, the government also raised the ceiling on foreign institutional investors' investment in corporate debt from $6 billion to $15 billion. Less than three months ago, the cap was just $3 billion. (Note: There are signs that investors are responding: net portfolio flows turned positive in November, partly because of corporate bond purchases. Deepening the corporate debt market is a key component of project finance for the infrastructure sector. End note.)

RBI LOWERS INTEREST RATES AGAIN

¶5. (U) The central bank, the Reserve Bank of India, also announced on January 2 that it would lower several of its policy rates. These include a 100 basis point reduction in its repo (liquidity injection) and reverse repo (liquidity absorption) rates to 5.5% and 4% respectively, as well as lowering the CRR from 5.5 to 5%. The RBI noted in its release that it is adjusting its policy stance from "demand management to arresting the moderation in growth." This can be taken as a confirmation of what seems to have been the RBI's approach since September - that it will continue to monitor and respond to perceived liquidity and lending needs in order to help re-start the growth momentum. The central bank can keep open the door to further interest rate reductions, as inflation continues to

fall, most recently at a ten-month low of 6.38%.

COMMENT

¶6. (SBU) Most estimates of the lag between monetary policy implementation and impact on economic activity range around 6-12 months, so full impact of the near halving of policy rates to date - with room for more reductions - may land in the second half of 2009. Most economists feel loosening restrictions on ECBs and foreign holdings of corporate bonds will be more meaningful as external markets normalize, perhaps in the second half of this year. So conditions for domestic market growth, especially investment, carry potential for big improvements, even if external markets drag behind. India's economy is being properly targeted by skilled policymakers and is encouraging liberalizing behavior; it could therefore surprise on the upside.

MULFORD